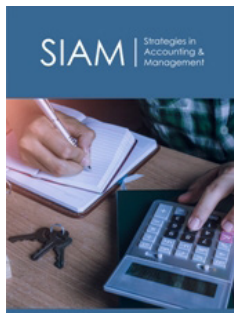


# Do IFRS Adoption Enhance the Financial Reporting Quality of DFM Listed Companies

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## Abstract

Different accounting standards may lead to differences in financial reporting and its quality even with same set of accounting data. Previous studies acquired through cross-country analyses show that the adoption of International Financial Reporting Standards (IFRS) improves considerably the financial reporting quality and comparability and thereby favorable economic consequences. In this research, we try to assess whether the quality of the financial reporting of listed non-financial companies in Dubai Financial Market (DFM) has been improved after the adoption of the IFRS or not. More precisely, we look in this research to the five fundamental characteristics of the accounting information, which are: (1) relevance, (2) faithful representation, (3) understandability, (4) comparability and (5) timeliness. For this purpose, we used a qualitative approach developed by the Nijmegen Centre of Economics (Nice). Our sample consist of all nonfinancial companies listed on DFM observed over the period from 2015 to 2018. By all counts, our research finding provide evidence that it is no wonder that the adoption of IFRS has increased the quality of financial reporting from year to year. The outcomes proved that the qualitative factors of relevance, understandability, and comparability level increased considerably after IFRS adoption. The findings of this paper could lead to high level of awareness about the importance of financial reporting quality. Higher level of IFRS compliance play a significant role in attracting global investors' interest to the local markets, especially in a developing country like the UAE.

**Keywords:** IFRS; Financial reporting quality; DFM; Nice; UAE

## Introduction

Nowadays the modern economies rely on cross-border transactions. More than a third of financial transactions occur cross-border and that number is expected to keep growing as the world economy grows. Therefore, applying international standards promoting higher level of transparency, accountability and efficiency would help investors diversify and extend their investment cross-border. The international financial reporting standards (IFRS) is a comprehensive international accounting framework developed to uniform financial reporting and disclosure across the world. Today, more than 120 countries adopted IFRS and make it mandatory for companies operating in their economies [1]. Rouse [2] argue that the main objective of IFRS is to bring a higher level of transparency, accountability and efficiency to the financial markets around the world, as well as provides guidance on how the statements should be prepared. Previous studies discussed the important role played by IFRS to improve transparency and guaranty better comparability of financial reports [3-12]. Indeed, IFRS requirements urge companies to increase the level and quality of information disclosed in the financial report, which in turn help decision-makers by allowing them to better understand competitors' financial reports and thereby enhances information transfers across many firms and across countries. The UAE has adopted the IFRS on 1 July 2015. Since that date, all listed companies have to prepare their financial statements according to IFRS. Other firms

are encouraged to use IFRS as well, except for certain government entities where International Public Sector Accounting Standards (IPSAS) is applied (IFRS.Org).

Launched as a public institution with an independent legal entity under Decree 14/2000 issued by the Government of Dubai, Dubai Financial Market (DFM) began its operations on 26 March 2000. On 27 December 2005, the Executive Council of Dubai chose to transform DFM into a public shareholding company with a capital of AED 8 billion split into 8 billion shares. The public offering was satisfied with a high need that surpassed all expectations, with agreements that amounted to AED 201 billion DFM. Within a short period, DFM has quickly evolved into a leading financial market beyond the GCC region. Its constant and strategic actions have strengthened Dubai as a center of supremacy in this area of the world and enriched its front position as a strong capital market hub that embraces the best global exercises to meet the evolving demands of its investors regionally and globally. DFM functions as a secondary market for the trading of securities issued by public shareholding companies, mutual funds, local public institutions, and bonds issued by federal or local governments, as well as any other domestic or foreign DFM approved financial instruments.

Therefore, it looks interesting to assess the effect of IFRS adoption on financial reporting quality of listed companies in DFM and to what extent IFRS promote the transparency of financial reporting of these companies. Using a sample of 20 listed non-companies in DFM observed over the period 2015-2018, we employ in this study a qualitative approach based on a financial reporting quality index developed by Nijmegen Center for Economics (NICE). Our paper findings reveal that the characteristics of accounting information namely relevance, faithful presentation, understandability and comparability has increased considerably year over year after the adoption of IFRS, which implies in turn, that financial reporting quality increased considerably from year over year. The reminder of the paper is organized as follows. Section 2 reviews the relevant prior studies. Section 3 describes sample selection, data sources and variables' definition and methodology. Section 4 highlights the research methodology and discusses the results. Section 5 concludes the paper and offer some recommendations.

## Literature Review

Previous studies discussed the effect of IFRS adoption on the quality of financial reporting and accounting information. Schipper [13] debates that IFRS help to improve financial statement comparability and allow investors and firms to make better investment decisions. Indeed, greater comparability increases the information available to decision-makers by allowing them to better understand competitors' financial reports and thereby enhances information transfers across many firms and across countries. By encouraging managers to prepare financial statements based on the essence of an economic transaction rather than a set of relatively inflexible rules, IFRS can ensure that managers account for like transactions in a like manner and dissimilar transactions differently. Barth [14] argue that IFRS adoption increase

significantly the comparability of financial statements across IFRS firms and a size-and industry-matched sample of US firms. Moreover, the comparability across IFRS and US firms is generally higher when the adoption of IFRS is mandatory. The authors provide evidence that 23 mandatory IFRS adoption and the international co-ordination of accounting regulations have improved the global comparability of accounting information. Healy [15], Leuz [16], Daske [17] show that the asymmetry of information decreased considerably after the adoption of IFRS due to the increase of the financial reporting quality. Alali [18], Karampinis [19] argue that by implementing IFRS, the financial statement presented became more relevant for two main reasons. First, IFRS are widely used. Second, IFRS employs the fair value method, which reflect the real economic situation of the company.

Jayaraman [10] document that IFRS-induced improvements in accounting comparability are around three times larger within euro-adopter countries than in other EU countries. They conclude that IFRS adoption is better at improving reporting comparability when the underlying economic environments are similar. Cascino [7] report that the comparability effect of mandatory IFRS adoption is mainly observed for public firms. Yip and Young conclude that IFRS adoption improves the cross-country comparability of financial information by making reports of similar firms look more alike but does not make reports of firms with different economic activities appear any more dissimilar. However, they note that comparability improvements are primarily observed only in firm pairs from countries with the same legal origin (measured as either common- or code-law countries). Nijam [20], taking into account many factors including such as, value relevance, disclosure quality, and cost of capital, show that different environments can affect the decision of adoption of IFRS. As an example, the adoption of IFRS in the UK has strengthened the quality of reporting. Loannis [21] argue that IFRS require providers of the financial statements to disclose greater information compared to domestic GAAP standards, that will allow the users of these financial statements to be able to have a better idea of what these firms are actually doing and their real standings in the market. As well as having a more in-depth disclosure requirements, the evaluation of the reporting quality of these companies depends on more information like the volume of information and their decision usefulness. In relation to the cost of capital, the adoption of IFRS has proven that it will improve the situation of the cost of capital for companies, as it will have better economic consequences especially if the companies adopt the IFRS voluntarily, before it is applied mandatorily by the government of a specific country. Yurisandi [3] examine the effect of the adoption of IFRS on the quality of the financial reporting for a sample of listed companies in the Indonesian Stock Exchange with the highest market capitalization, and covering the period from 2009 to 2013, with 2009-2010 being the pre-IFRS period and the 2012-2013 period is considered the post-IFRS period. The paper findings provide evidence that quality of financial reporting enhanced considerably after IFRS adoption. Van Beest [4] discusses the effect of IFRS on Relevance, Representational Faithfulness,

Understandability, Comparability, and Timeliness. The paper findings shows that the adoption of IFRS standards has increased the financial reporting quality across all these factors except for Representational Faithfulness which had shown a negative trend, and the Timeliness had a very small change and it was not significant. While the effect of IFRS adoption on the financial reporting quality have been discussed widely on developed countries, little is known about its impact on the UAE companies. Therefore, we extend previous research on the field by assessing the effect of IFRS adoption on the reporting quality of listed companies in DFM.

## Material and Method

To assess the effect of IFRS adoption on the financial reporting quality of DFM listed non-financial companies, we employed a qualitative index developed by Nijmegen Centre for Economics (Nice) developed by van Beest [4] and used by previous studies such as: Yurisandi [3]. Nice developed a comprehensive five point Likert scale financial reporting quality index based on IASB and FASB requirements regarding the qualities of the disclosed accounting information, which are relevance, faithful representation, understandability, comparability and timeliness. The qualitative characteristic of relevance, faithful representation, understandability, comparability, verifiability and timeliness were operationalized into to 21 questions with a 5-point Likert

scale option. However, verifiability and timeliness are the two qualitative characteristics not captured by Nice model were added into the model. The 5-point Likert scale options attracts between a minimum score of 1 point (poor position) and a maximum score of 5 points (excellent position). Table 1 provide a full description of Nice reporting quality index. A t- test was utilised for the data analysis. Indeed, the t-test allows reporting quality a continuous dependent variable to scale against categorical variable reporting regime. In testing the hypothesis, the means scores generated through Nice reporting quality index were compared over the years of observation. Moreover, the test was carried out at 5% level of significance. Our sample consists of listed companies in DFM. The firms included in our sample, have to satisfy the three conditions: First, it has to belong to a non-financial sector. Financial companies firms such as banks, insurance firms and investment firms are excluded because their reports are not comparable to those of non-financial firms. Second, this study focuses on financial reports and not other media of financial communications such as interim reports. Third, the non-financial firm, has to have at least one annual report, from 2015-2018. We choose 2018 as the end year for the study because some listed companies did not publish yet the financial report of 2019. Our sample consisted of 20 non-financial companies.

**Table 1:** Nice Index.

	Question no	Question	Operationalization	Concept
Relevance	R1	To what extent does the presence of the forward looking statement help forming expectations and predictions concerning the future of the company?	1 = No forward-looking information, 2 = Forward-looking information not an apart subsection, 3 = Apart subsection 4 = Extensive predictions, 5 = Extensive predictions useful for making expectation	Predictive value
	R2	To what extent does the presence of non-financial information in terms of business opportunities and risks complement the financial information?	1 = No non-financial information, 2 = Little non-financial information, no useful for forming expectations, 3 = Useful non-financial information 4 = Useful non-financial information, helpful for developing expectations 5 = Non-financial information presents additional information which helps developing expectations	Predictive value
	R3	To what extent does the company use fair value instead of historical cost	1 = Only HC 2 = Most HC 3 = Balance FV/HC 4 = Most FV 5 = Only FV	Predictive value
Faithful representation	R4	To what extent do the reported results provide feedback to users of the annual report as to how various market events and significant transactions affected the company?	1 = No feedback 2 = Little feedback on the past 3 = Feedback is present 4 = Feedback helps understanding how events and transactions influenced the company 5 = Comprehensive feedback	Confirmatory value
	F1	To what extent are valid arguments provided to support the decision for certain assumptions and estimates in the annual report?	1 = Only described estimations 2 = General explanation 3 = Specific explanation of estimations 4 = Specific explanation, formulas explained etc. 5 = Comprehensive argumentation	Verifiability
	F2	To what extent does the company base its choice for certain accounting principles on valid arguments?	1 = Changes not explained 2 = Minimum explanation 3 = Explained why 4 = Explained why + consequences 5 = No changes or comprehensive explanation	Verification
	F3	To what extent does the company, in the discussion of the annual results, highlight the positive events as well as the negative events?	1 = Negative events only mentioned in footnotes 2 = Emphasize on positive events 3 = Emphasize on positive events, but negative events are mentioned; no negative events occurred 4 = Balance pos/neg events 5 = Impact of pos/neg events is also explained	Neutrality

	F4	Which type of auditors' report is included in the annual report?	1 = Adverse opinion 2 = Disclaimer of opinion 3 = Qualified opinion 4 = Unqualified opinion: Financial figures 5 = Unqualified opinion: Financial figures + internal control	Free from material error, verification, neutrality, and completeness
	F5	To what extent does the company provide information on corporate governance?	1 = No description CG 2 = Information on CG limited, not in apart subsection 3 = Apart subsection 4 = Extra attention paid to information concerning CG 5 = Comprehensive description of CG	Completeness, verifiability, and free from material error
Understandability	U1	To what extent is the annual report presented in a well organized manner?	Judgment based on: - complete table of contents - headings - order of components - summary/ conclusion at the end of each subsection	Understandability
	U2	To what extent are the notes to the balance sheet and the income statement sufficiently clear?	1 = No explanation 2 = Very short description, difficult to understand 3 = Explanation that describes what happens 4 = Terms are explained (which assumptions etc.) 5 = Everything that might be difficult to understand is explained	Understandability
	U3	To what extent does the presence of graphs and tables clarifies the presented information?	1 = no graphs 2 = 1-2 graphs 3 = 3-5 graphs 4 = 6-10 graphs 5 = >10 graphs	Understandability
	U4	To what extent is the use of language and technical jargon in the annual report easy to follow?	1 = Much jargon (industry), not explained 2 = Much jargon, minimal explanation 3 = Jargon is explained in text/ glossary 4 = Not much jargon, or well explained 5 = No jargon, or extraordinary explanation	Understandability
	U5	What is the size of the glossary?	1 = No glossary 2 = Less than 1 page 3 = Approximately one page 4 = 1-2 pages 5 = >2 pages	Understandability
Comparability	C1	To what extent do the notes to changes in accounting policies explain the implications of the change?	1 = Changes not explained 2 = Minimum explanation 3 = Explained why 4 = Explained why + consequences 5 = No changes or comprehensive explanation	Consistency
	C2	To what extent do the notes to revisions in accounting estimates and judgements explain the implications of the revision?	1 = Revision without notes 2 = Revision with few notes 3 = No revision/ clear notes 4 = Clear notes + implications (past) 5 = Comprehensive notes	Consistency
	C3	To what extent did the company adjust previous accounting period's figures, for the effect of the implementation of a change in accounting policy or revisions in accounting estimates?	1 = No adjustments 2 = Described adjustments 3 = Actual adjustments (one year) 4 = 2 years 5 = >2 years + notes	Consistency
	C4	To what extent does the company provide a comparison of the results of current accounting period with previous accounting periods?	1 = No comparison 2 = Only with previous year 3 = With 5 years 4 = 5 years + description of implications 5 = 10 years + description of implications	Consistency
	C5	To what extent is the information in the annual report comparable to information provided by other organizations?	Judgment based on: - accounting policies - structure - explanation of events In other words: an overall conclusion of comparability compared to annual reports of other organizations	Comparability
	C6	To what extent does the company present financial index numbers and ratios in the annual report?	1 = No ratios 2 = 1-2 ratios 3 = 3-5 ratios 4 = 6-10 ratios 5 = > 0 ratios	Comparability
Timeliness	T1	How many days did it take for the auditor to sign the auditors' report after bookyear end?	Natural logarithm of amount of days 1 = 1-1.99 2 = 2-2.99 3 = 3-3.99 4 = 4-4.99 5 = 5-5.99	Timeliness

## Result and Discussion

Table 2A & 2B report our main descriptive statistics for our sample. As reported in Table 2A, the financial reporting quality index has increased from 63.33 in 2015 to 73.08 in 2018 showing a higher level of reporting quality especially for relevance, faithful

representation, understandability and comparability. Table 2B reports the descriptive statistics for our sample. The average financial reporting quality index is 69.2 (median is 69.5) the average Relevance score is 12.87 (median is 13), the average Faithful representation score is 17.10 (median is 17), the average Understandability score is 16.9 (median is 17). The average

Comparability score is 18.77, a median of 17.5, a minimum of 13, a maximum of 28, and a standard deviation of 3.68. The average Timeliness score is of 3.54 (median is 4). The Timeliness score for our listed companies varies from 1 to 5.

**Table 2A:** The evolution of the financial reporting quality during 2015-2018.

	Financial Reporting Quality Index	Relevance	Faithful Representation	Understandability	Comparability	Timeliness
2015	63.33	10.92	15.67	15.83	17.58	3.33
2016	68.53	13.08	16.89	16.74	18.22	3.61
2017	71.15	13.31	17.62	17.46	19.15	3.62
2018	73.08	14	18.08	17.42	20	3.58

**Table 2B:** Descriptive statistics.

	Financial Reporting Quality Index	Relevance	Faithful Representation	Understandability	Comparability	Timeliness
Mean	69.19	12.88	17.1	16.9	18.77	3.54
Median	69.5	13	17	17	17.5	4
Min	53	7	13	11	13	1
Max	92	17	22	24	28	5
St.dev	8.23	2.57	2.54	3.53	3.68	1.05

Table 3 reports our main findings of T-test of variation of the Financial Reporting Quality index after IFRS adoption. According to Table 3, the overall financial reporting quality index has increased from year to year after the IFRS adoption. The results are significant at a level of 1%. The same finding is reported for the components of the financial reporting quality index: relevance, faithful representation, understandability and comparability. However, we did not observe a difference for timeliness quality after the adoption of IFRS. Indeed, after the adoption of IFRS in 2015, companies need more time to prepare its financial statements according to IFRS presentation and disclosure requirements. The passage from pre IFRS to post IFRS, will be costly for companies and may require longer time for companies to respond to IFRS requirements. Our findings are in line with Barth [5] findings showing that the

accounting quality increased considerably after the implementation of international accounting standards because of the increasing from timely loss recognition and the value relevance. Yurisandi [3] report that financial reporting quality has improved extensively after the adoption of IFRS in Indonesia compared to the pre IFRS implementation. Beest [4] provide evidence that the relevance of the financial reporting using IFRS increased when we compared with those using US GAAP. Indeed, the information disclosed in the financial statements prepared according to international accounting standards, reflect better the real economic condition and financial position of companies comparing those prepared according to US GAAP. Therefore, the character of faithful presentation of the financial reporting is more visible after IFRS adoption [22].

**Table 3:** T-test- Financial reporting quality over 2015-2018.

	2015	2016	2017	2018	T-test	Significance
Financial Reporting Quality Index	63.3	68.5	71.2	73.1	3.21	0.000***
Relevance	10.9	13.1	13.3	14.0		
R1	2.6	3.5	3.5	3.8		
R2	2.3	3.3	3.1	3.4		
R3	2.7	2.8	3.1	2.9		
R4	3.3	3.4	3.7	3.8		
Faithful Representation	15.7	16.9	17.6	18.1	3.22	0.000***
F1	3.2	3.5	3.8	3.8		
F2	3.1	3.7	3.9	3.9		
F3	2.6	2.7	2.8	3.3		
F4	4.3	4.2	4.1	4.3		
F5	2.6	2.8	3.0	2.9		
Understandability	15.8	16.7	17.5	17.4	3.47	0.000***



U1	2.4	2.5	2.7	2.6		
U2	4.2	4.1	4.5	4.8		
U3	2.1	2.7	2.6	2.4		
U4	2.7	3.0	3.0	3.0		
U5	4.5	4.5	4.6	4.7		
Comparability	17.6	18.2	19.2	20.0	2.34	0.000***
C1	3.6	3.5	3.7	4.0		
C2	3.4	3.5	3.5	3.8		
C3	2.6	3.0	3.2	3.3		
C4	2.3	2.5	2.7	2.9		
C5	2.8	2.7	3.2	3.0		
C6	2.9	3.0	2.8	3.0		
Timeliness	3.3	3.6	3.6	3.6	1.21	0.8

\*\*\*Significant at 1%.

## Conclusion

In this paper we try to assess whether there is an increase in financial reporting quality after the adoption of IFRS or not for a sample of non-financial companies listed in DFM during the period 2015-2018. Using the Nice financial reporting index, our study provides evidence the characteristics of accounting information namely relevance, faithful presentation, understandability and comparability has increased considerably year over year after the adoption of IFRS, which implies in turn, that financial reporting quality increased considerably from year over year. Our paper contributes to the literature on financial reporting in general and in the UAE context in particular. Indeed, this is the first paper assessing the effect of IFRS adoption on the quality of financial reporting of listed companies in UAE. Our findings may be considered as a pilot to serve as the basis for further research discussing the determinants of financial reporting quality after the adoption of IFRS.

As regards the practical implications of our research, our finding seems to be useful for both preparers and users of annual reports, for regulators and policy makers. Indeed, the results of this paper could lead to high level of awareness about the importance of financial reporting quality. Higher level of IFRS compliance play a significant role in attracting global investors' interest to the local markets, especially in a developing country like the UAE. Therefore, DFM listed companies have to work further on improving the level of financial reporting quality by disclosing of more information related to business risk and opportunities to help investors to make relevant investment decisions.

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